(1935 - 2010)
प्लैटिनम जयंती
PLATINUM JUBILEE

प्रेस प्रकाशनी PRESS RELEASE

भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA

संचार विभाग, केंद्रीय कार्यालय, एस.बी.एस.मार्ग, मुंबई 400001
DEPARTMENT OF COMMUNICATION, Central Office, S.B.S. Marg, Mumbai 400001
फोन/Phone: 91 22 2266 0502 फैक्स/Fax: 91 22 2270 3279

वेबसाइट : www.rbi.org.in/hindi
Website : www.rbi.org.in
इ-मेल email: helpdoc@rbi.org.in

April 21, 2009

Annual Policy Statement - 2009-10 - Press Statement by Dr. D. Subbarao, Governor

"This morning, I had a meeting with the chiefs of major banks where we announced the annual policy of the Reserve Bank for 2009-10. The meeting also provided a valuable opportunity for the Reserve Bank and the commercial banks to understand and appreciate each others' perspectives.

The annual policy statement for 2009-10 is set in the context of a deep global economic slump and financial market turmoil. Governments and central banks around the world have responded to the crisis through both conventional and unconventional fiscal and monetary measures. And there is unprecedented co-ordinated policy action globally.

The Crisis and India

Like all emerging economies, India too has been impacted by the crisis, and much more than was expected earlier. GDP growth has moderated reflecting lower industrial production, negative exports, deceleration in services activities, dented corporate margins and diminished business confidence. There are some comforting factors — well-functioning financial markets, robust rural demand, lower headline inflation and comfortable foreign exchange reserves — which buffered us from the worst impact of the crisis. The fiscal stimulus packages of the Government and monetary easing and regulatory action of the Reserve Bank have helped to arrest the moderation in growth and keep our financial markets functioning normally.

Monetary Policy Action

Consistent with the current assessment of macroeconomic and monetary conditions, the Reserve Bank has decided to:

- reduce the repo rate under the LAF by 25 basis points from 5.0% to 4.75% with immediate effect.
- reduce the reverse repo rate under the LAF by 25 basis points from 3.5% to 3.25% with immediate effect.
- keep the CRR unchanged at 5.0% of net demand and time liabilities (NDTL).

Reserve Bank's Policy Thrust

The thrust of the Reserve Bank's policy stance since mid-September 2008 has been aimed at providing ample rupee liquidity, ensuring comfortable dollar liquidity and maintaining continued credit flow to productive sectors. Taken together, the policy measures of the Reserve Bank have ensured that the Indian financial markets continue to function in an orderly manner. These measures have augmented actual/potential liquidity in the financial system by over Rs.420,000 crore. This should assure financial markets that the Reserve Bank will continue to maintain comfortable liquidity.

Interest Rate Response from Banks

Banks have told us of the constraints they face in further downward adjustment of deposit and lending rates, and these are discussed in the policy statement. Some of the banks' apprehensions are valid and some not. Within the policy rate adjustment already effected by the Reserve Bank, there is scope for banks to further reduce lending rates so as to ensure credit flow for all productive economic activity. We hope and expect that banks will play their part in the economic adjustment process by passing on the benefits of lower interest rates to their customers.

Government Borrowing

Government borrowing increased substantially in 2008-09. As you will note from the numbers in the policy statement, net borrowing by the Central Government in 2008-09 was nearly three times that in 2007-08. As per estimates in the interim budget, net borrowing in the current year, 2009-10, will also be at this elevated level. Even as the increase in borrowing was large and abrupt in the fourth quarter of 2008-09, we managed that in a non-disruptive manner through a combination of measures such as unwinding of the MSS securities, open market operations and monetary easing. Admittedly, yields had increased. However, it is important to reckon with the counterfactual. But for the offsetting liquidity easing done by the Reserve Bank, yields would have increased even more. We will manage the borrowing in 2009-10 in a similarly non-disruptive manner. An effort in this regard is the planned OMO purchases and MSS unwinding in the first half of 2009/10 that will add primary liquidity of about Rs.120,000 crore, the monetary impact of which is equivalent to CRR reduction by 3 percentage points.

Growth Outlook

Let me now turn to the growth prospects. In the January 2009 policy review, we projected growth for 2008-09 of 7.0 per cent with a downward bias. The downside risks have since materialised, and GDP growth for 2008-09 is now projected to turn out to be in the range of 6.5-6.7 per cent. Going forward, the fiscal and monetary stimulus measures initiated during 2008-09 coupled with lower commodity prices will cushion the downturn by stabilising domestic economic activity. On balance, with the assumption of a normal monsoon, for policy purpose real GDP growth for 2009-10 is placed at around 6.0 per cent.

Inflation Outlook

Keeping in view the global trend in commodity prices and domestic demand-supply balance, we project WPI inflation at around 4.0 per cent by end-March 2010. Headline WPI inflation decelerated sharply after August 2008 reflecting the fall in global commodity prices. CPI inflation continues to be at near double-digit level but is expected to moderate in the coming months. WPI inflation, however, is expected to be in the negative territory in the early part of 2009-10 which is only of statistical significance and is not a reflection of demand contraction as is the case in advanced economies.

Money Supply

Money supply (M_3) growth for 2009-10 is placed at 17.0 per cent. Consistent with this, the aggregate deposits of commercial banks are projected to grow by 18.0 per cent. The growth in adjusted non-food credit, including investment in bonds/debentures/ shares of public sector undertakings and private corporate sector and CPs, is placed at 20.0 per cent. As always, these numbers are indicative projections and not targets.

Challenges on the way forward

There are several immediate challenges facing the economy. These include: (a) supporting the drivers of aggregate demand to enable the economy to return to its high growth path; (b) boosting the flow of credit to all productive sectors of the economy; (c) managing the large government borrowing programme in 2009-10 in a non-disruptive manner; (d) restoring the fiscal consolidation process; (e) ensuring an orderly withdrawal of the large liquidity injected in the system since September 2008 by the Reserve Bank to support the economy's productive requirements; and (f) the continued challenge of preserving the stability of our financial system drawing from the lesson of the global crisis.

Finally, the overarching challenge is to ensure an interest rate environment that supports revival of investment demand. Since October 2008, as the inflation rate has decelerated and the policy rates have been cut, market interest rates have also come down. But the reduction in interest rates across the term structure and across markets has not been uniform. Let me therefore reiterate that there is scope for the overall interest rate structure to adjust downwards. Indeed, the further policy rate cuts effected as part of this policy should be a definitive signal for reducing lending rates.

Monetary Policy Stance

On the basis of this overall assessment, the stance of monetary policy in 2009-10 will broadly be as follows:

- Ensure a policy regime that will enable credit expansion at viable rates while preserving credit quality so as to support the return of the economy to a high growth path.
- Continuously monitor the global and domestic conditions and respond swiftly and effectively through policy adjustments as warranted so as to minimize the impact of adverse developments and reinforce the impact of positive developments.
- Maintain a monetary and interest rate regime supportive of price stability and financial stability taking into account the emerging lessons of the global financial crisis.

Developmental and Regulatory Issues

Let me now turn to development and regulatory issues. In tailoring these policies, we have been mindful of the lessons of the global financial crisis as they apply to India. The policy statement has a detailed listing and explanation. I will only highlight a few.

Our banking system remains inherently sound and the financial markets are functioning normally. In the wake of the global financial crisis, however, several initiatives have been taken in an unprecedented coordinated manner at the global level with a view to resolving the crisis and strengthening the international financial architecture. India has been a part of the various global initiatives. A comprehensive assessment of the Indian financial sector was undertaken by the Committee on Financial Sector Assessment (CFSA) which found India’s financial sector to be broadly sound and resilient, identified some concerns and made several recommendations. The Reserve Bank proposes to set up a Task Force with regard to the G-20 Working Groups; Working Group to implement the recommendations of the CFSA; and Financial Stability Unit in the Reserve Bank.

Policy measures relating to interest rate include constitution of a Working Group to review the present BPLR system to make credit pricing more transparent; and payment of interest on savings bank accounts on a daily product basis with effect from April 1, 2010.

Measures relating to financial markets include:

- Further liberalisation of the FCCBs buyback policy;

- Extension of the relaxation on the all-in-cost ceilings for ECBs up to December 31, 2009;
- Extension of the special refinance facility and term repo facility and increased limit for export credit refinance for banks up to March 31, 2010;
- Introduction of STRIPS to aid the development of a sovereign zero-coupon yield curve; and
- Revise the issuance structure of floating rate bonds, among others.

Policy measures relating to credit delivery mechanism and banking services include:

- Issuing guidelines to banks on rehabilitation of sick SMEs;
- Phased introduction of capital to risk-weighted asset ratio (CRAR) for regional rural banks (RRBs);
- A non-disruptive roadmap to ensure that only banks with licence operate in the co-operative space by 2012; and
- Setting up banking facilities at commercially unviable centres in the North-Eastern region.

The major prudential measures include allowing scheduled commercial banks (SCBs) to set up offsite ATMs without prior approval subject to reporting, lay down the norms for capital adequacy treatment of exposures of banks to central counterparties, prescribe a minimum lock-in-period and minimum retention criteria for securitising the loans, increase the maximum distance criterion for business correspondent for deeper penetration of banking services.

In view of the current global financial market turmoil, it has also been decided to continue, for the time being, with the current policy and procedures governing the presence of foreign banks in India. The review proposed as part of the 2005 policy on the subject will be taken up after due consultation with all stakeholders once there is greater clarity regarding the stability of the global financial system and a shared understanding on the regulatory and supervisory architecture around the world.

The measures relating to institutional developments include:

- Permit eligible SCBs to issue all categories of pre-paid payment instruments;
- Permit eligible non-bank entities, including NBFCs, to issue semi-closed instruments;
- Permit extension of area of operation of Tier II urban co-operative banks (UCBs) in Grade I to the entire State of registration;
- Guidelines to UCBs on internal controls, risk management systems, ALM and disclosure norms;
- Apply capital charge for market risks in respect of large UCBs; and
- Defer the implementation of CRAR for NBFCs-ND-SI by one year."

G. Raghuraj
Deputy General Manager

Press Release : 2008-2009/1736